

OFFICE OF UNITED STATES TRUSTEE

MEMORANDUM

DATE: June 29, 1998

TO: Persons interested in serving on official Committees of Unsecured Creditors

FROM: Ira Bodenstein United States Trustee

SUBJECT: Information for Persons Interested in Serving on Official Committees of Unsecured Creditors

As an unsecured creditor of a bankruptcy estate, you may be solicited to serve as a member of the creditors' committee in a chapter 11 case pending in the Northern District of Illinois. The committee will ordinarily, but not always, consist of the seven largest unsecured creditors in the case. This memorandum is intended to provide you with information concerning creditor committee participation, as well as acquaint you generally with the bankruptcy process.

Chapter 11 Generally

A chapter 11 case is commenced by the filing of a petition in Bankruptcy Court. It is usually filed voluntarily by the debtor. Chapter 11 cases differ from chapter 7 cases in several ways, including the following:

1 . In chapter 7, the bankruptcy estate is always liquidated. In chapter 11, the debtor may seek to rehabilitate, reorganize, or liquidate, if appropriate.

2. In chapter 7, the United States Trustee always appoints a trustee to administer the estate. In chapter 11, however, the debtor retains control of its assets and business operations, unless the court orders the appointment of a chapter 11 trustee.
3. Creditor committees are routinely appointed in chapter 11 cases only.

In its petition for relief, the chapter 11 debtor states its intention to file a plan. While the purpose of all chapter 11 plans is to deal in some way with prepetition debt, there is great flexibility in the type of plan that can be proposed. The plan may seek to extend repayment periods, reduce certain classes of debt, accept or reject certain contracts, reorganize through merger or major infusion of capital, liquidate in an orderly manner, etc. The debtor has the exclusive right to file a Plan during the first 120 days after the case is filed, unless it has elected to be treated as a small business, in which case it has the exclusive right to file a plan during the first 100 days after the case is filed. To qualify as a small business a debtor may have no more than \$2,000,000.00 in debt.

Generally, before a plan can be circulated to creditors and voted upon, a hearing on the disclosure statement must be held. At that hearing, the person proposing the plan must demonstrate to the court that the disclosure statement sets forth enough information to enable creditors to make an informed decision as to whether to accept or reject the plan. If the court is convinced that the disclosure is adequate, the plan, disclosure statement, and ballots will be mailed to creditors for their vote. If the plan is then accepted by creditors and confirmed by the court, payment to creditors can begin according to the terms of the plan.

Sometimes the court will combine the hearing on the disclosure statement with confirmation of the plan. This procedure expedites cases and is intended to enhance the debtor's ability to reorganize and pay dividends to creditors. If this procedure is used, you will still have an opportunity to object to the disclosure statement or plan and vote on whether to accept the plan.

Role of the Creditors' Committee

The creditors' committee does not "run the business" or otherwise control the assets of the estate. The debtor in possession (or trustee, if one has been appointed) is in control. Nevertheless, the creditors' committee has significant powers under the Bankruptcy Code. An active committee can, and often does, greatly affect the outcome and administration of a chapter 11 case.

The committee represents the interest of all unsecured creditors in a fiduciary capacity. There are times in a chapter 11 case when the debtor may propose some action (e.g., the sale of property) and *only* send notice to the creditors' committee. Therefore, it is extremely important for the committee to carefully review these proposals and decide whether any objection should be raised.

The committee's fundamental role is to negotiate and obtain the best repayment plan possible for all unsecured creditors. To achieve that goal, the Bankruptcy Code, in Section 1103, details the specific powers and duties of the committee.

The committee may:

- 1 . Employ an attorney and/or accountant to work for it. With the court's approval, these professionals are paid out of the assets of the estate. The hiring must be reasonable and justified under the particular circumstances.
2. Review the progress and status of the case and discuss their concerns with the debtor. The debtor is required to file monthly operating and financial reports with the United States Trustee, the creditors' committee and the court. These reports provide valuable information for the creditors' committee.
- 3 Investigate the operation of the debtors business, the desirability of its continuance, and the prospects of its rehabilitation.
4. Participate in the formulation of a plan. Is it feasible? Can it be confirmed?

5. Ask the court to appoint an examiner in the case. An examiner is a professional with the expertise to investigate the debtor's business and who will file a report regarding the viability of the business, competence of past or current management, possible fraud, etc. The court will only direct the appointment of an examiner for cause shown, such as, among other things, fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor by current management. Therefore, if the committee desires the appointment of an examiner, it should consider hiring competent legal counsel to advise it and to file and argue the motion before the court.
6. Request the appointment of a trustee. A trustee is an independent third party charged with the responsibility of controlling estate assets. As with an examiner, the court will only direct the appointment of a trustee for cause, as set forth above, or if it is in the best interest of creditors. Again, the committee would benefit from the services of an attorney if it seeks appointment of a trustee.
7. Ask the court to either dismiss the case or to convert it to one under chapter 7 (liquidation). One cause for dismissal or conversion is unreasonable delay which is prejudicial to creditors. If the debtor has missed deadlines specifically set by the court, or has failed to file the required monthly financial reports, the creditors should bring the matter before the court. (Remember that where a debtor is a debtor in possession, there is no trustee to keep the case moving.)
8. Please remember that if appointed to the committee, you will be charged with representing the best interests of creditors generally as contrasted with your own claim in the case. In the event that your actions become merely self-serving, you may be asked to resign from the committee or be administratively removed from membership.

Meetings

The meeting of creditors is set by the United States Trustee and noticed by the Bankruptcy Clerk. The reverse side of the notice contains a proof of claim form, which creditors should complete and file with the Clerk. Either before or during the first meeting of creditors, the representative of the United States Trustee will attempt to appoint a creditors' committee. In cases where the debtors debt structure or initial creditor interest indicates a strong likelihood that a committee can be organized before the first meeting of creditors, the United States Trustee meets with the twenty largest creditors to form a committee. Once formed, it is important for the committee to select a chairperson, retain an attorney, if appropriate, review the financial condition of the debtor as of the petition date, review the debtors operations post petition,

and consider, on an ongoing basis, what actions are in the best interest of the unsecured creditor body as a whole. Subsequent committee meetings should be set by the committee.

Additional Committees to Represent

Interests of Other Constituencies

The United States Trustee is authorized to appoint additional committees to represent the interests of other parties when warranted by the circumstances. These committees serve in addition to the committee of unsecured creditors. Typical examples of additional committees would include a committee of customers who have deposited monies with the debtor for consumer goods, a committee of public investors and a committee of shareholders. Once appointed by the United States Trustee, these additional committees have the same powers and duties as the Official Unsecured Creditors' Committee. Such additional committees represent the interest of all parties having claims of that nature in a fiduciary capacity.

Service on a committee is purely voluntary. Nevertheless, it is strongly encouraged. Our statistics show that cases with active creditor committees tend to be more successful than those without. Your conscientious efforts are likely to benefit all creditors. The United States Trustee appreciates your active participation in this important process.